(2013) 04 GUJ CK 0117

Gujarat High Court

Case No: Special Civil Application No. 3049 of 2013

Reckitt Benckiser Healthcare India Ltd.		APPELLANT
	Vs	
Assistant Commissioner of Income Tax (OCD)		RESPONDENT

Date of Decision: April 29, 2013

Citation: (2014) 360 ITR 427

Hon'ble Judges: S.G. Gokani, J; Akil Kureshi, J

Bench: Division Bench

Advocate: S.N. Soparkar and B.S. Soparkar, for the Appellant; Paurami B. Sheth, for the Respondent

Judgement

Akil Kureshi, J.

Heard learned counsel for the parties for final disposal of the petition. The petitioner has challenged a notice dated March 22, 2012, issued by the respondent-Assistant Commissioner of income tax u/s 148 of the income tax Act, 1961 (hereinafter referred to as "the Act"). The petition arises in the following background:

1.1 The petitioner is a company registered under the Companies Act, 1965. For the assessment year 2007-08, the petitioner filed its return of income on October 28, 2007, declaring a total income of Rs. 57.52 crores (rounded off). Such return was taken in scrutiny by the Assessing Officer. He framed assessment u/s 143(3) of the Act on March 17, 2009. It is this scrutiny assessment which the respondent intended to reopen for which impugned notice has been issued.

1.2 At the request of the petitioner, the respondent supplied the reasons recorded for issuing the notice. Such reasons read as under:

On verification of the details filed during the assessment proceedings, it is noticed from the grouping of expenses that the assessee had debited to profit and loss account an amount of Rs. 86,17,002 under the head of administrative expenses

being SAP implementation charges in A/c No. 3AS05. It is an expense of capital nature and should not have been allowed as revenue expenditure. This requires to be disallowed. The software implementation charges are capital in nature and it will be capitalized along with SAP software shown for Rs. 25,01,462. It will be entitled to depreciation as per prescribed rate. Thus, the amount of Rs. 86,17,002 requires to be disallowed.

The disallowance has been made u/s 14A of the Act to the extent of Rs. 2,11,316, as per paragraph 6 of the assessment order. The disallowance u/s 14A cannot be made on ad hoc basis but accordingly to the provisions of section 14A read with rule 8D of income tax Rules, 1962. The Central Board of Direct Taxes Notification No. 45 of 2008 dated March 24, 2008 (see (2008) 299 ITR (St.) 88), should be considered while making disallowance u/s 14A of the Act. In this case, assessee derived income from dividend amounting to Rs. 1,45,30,317 from the investment shown of Rs. 74,33,49,881. The disallowance u/s 14A would be as under:

(I) Interest which is not directly attributable to any income = where

A = Interest other than interest directly relating to income which does not form part of total income:

Rs. 2,12,69,284

B = Average value of investment, income of which does not form part of total income: Rs. (25,09,57,810 + 3,02,07,369)/2 = Rs. 14,05,82,589

C = Average of total assets in balance-sheet: Rs. (191,84,66,092 + 126,69,84,501)/2 = Rs. 159,27,25,296

Now, disallowance would be

Further, 0.5 per cent of average value of investment, income of which does not form part of total

Thus, there is total under assessment of income of Rs. 34,46,800 [being capital expenditure towards SAP after allowing depreciation at 60 per cent thereon (86,17,002 less 60 per cent Rs. 51,70,202)] + Rs. 29,20,815 = Rs. 63,67,615, which has resulted in short levy of tax.

Accordingly, I am satisfied that the income chargeable to tax has escaped assessment and hence it is a fit case for reopening the assessment within the meaning of section 147 of the Act.

1.3 Armed with the reasons, the petitioner raised detailed objections under a communication dated October 11, 2012. Such objections were, however, rejected by the respondent by an order dated March 8, 2013. Hence, this petition.

2. At the outset we may record that the impugned notice has been issued within a period of four years from the end of relevant assessment year. From the reasons

recorded, it emerges that there were two grounds on which the respondent based his notice for reopening. First was that the assessee, according to the respondent, claimed expenditure of Rs. 86.17 lakhs (rounded off) related to SAP implementation charges. In his opinion, such expenditure was capital in nature. The assessee wrongly claimed the same as revenue expenditure.

In this respect, the case of the petitioner from the outset has been that the petitioner never claimed such expenditure by way of revenue expenditure. In fact, the petitioner had treated such expenditure as "capital work-in-progress". In the objections that the petitioner raised also this aspect was highlighted. It was contended as under:

1. Expenses related to SAP implementation charges amounting to Rs. 86,17,002

1.1 In the subject reassessment notice, it has been alleged that the assessee has debited an amount of Rs. 86,17,002 under the head administrative expenses being SAP implementation charges and the same being in the nature of capital expenditure is required to be capitalized and not allowed as revenue expenditure.

1.2 In this regard, RBHIL wishes to submit that during the year ended March 31, 2007, RBHIL had capitalized the amount of Rs. 86,17,002 in its books under the head ''capital work-in-progress''. The assessee had not claimed the same as revenue expenditure.

1.3 Since the assessee has not claimed the SAP implementation charges as revenue expenditure or depreciation thereon during the year under consideration, RBHIL submits that there is no escapement of income.

1.4 Further, RBHIL wishes to submit that SAP implementation charges were initially grouped under the head administrative expenses but while finalizing the financial statements, the said charges were capitalised under the head "capital work-in-progress" and not booked under the head administrative expenses. A copy of audited financial statements along with the schedule of administrative charges and break-up of the capital work-in-progress are collectively enclosed as annexure-2.

3. Such objection was rejected by the Assessing Officer in his order dated March 8, 2013, in following terms:

3. The assessee raised objections to reopening assessment vide its letter dated October 11, 2012. The assessee has essentially contested the reopening of assessment proceedings objecting to the reasons recorded. With regard to the first reason, the assessee has stated that it had capitalized the amount of Rs. 86,17,002 in its books and had not claimed it as revenue expenditure. However, the assessee has itself accepted in its reply that initially it had claimed the entire expense of Rs. 86,17,002 as administrative expense which was debited to profit and loss account and only later capitalized the same as CWIP during finalization of accounts. The

assessee has not given any proof that while computing its returned income it had correctly treated the said expenditure. This issue was not examined during assessment proceedings and, hence, there is every reason to believe that income has escaped assessment as per u/s 147.

4. In the petition also, the clear stand of the petitioner has been that such expenditure of Rs. 86.17 lakhs was never treated as revenue expenditure. Such stand comes out from the following portion of paragraph 3.2:

3.2... It is submitted that one of the grounds on the basis of which the reopening of assessment is sought to be done is that the SAP implementation charges of Rs. 86,17,002 are debited profit and loss account under the head of administrative expenditure even though it is an expense of capital nature. The said ground is factually incorrect because the petitioner herein has never treated SAP implementation charges as revenue expenditure in its financial statement. On the contrary the SAP implementation of Rs. 86,17,002 are shown as capital work-in-progress in the financial statements of the petitioner herein. The said fact becomes apparent from the audited accounts of the petitioner herein. Hence, the ground for the reopening is factually incorrect and the impugned notice deserves to be quashed and set aside on this short count.

5. Even while issuing notice to the respondent on March 18, 2013, we had recorded the submission of the learned counsel for the petitioner that the petitioner had not claimed such expenditure as revenue expenditure.

6. From the above, it emerges that in so far as the first ground is concerned, the petitioner''s case all throughout has been that the amount in question was never treated as revenue expenditure. Such ground, thus, lacks validity. Such contention raised in the objections raised by the petitioner was dismissed by the Assessing Officer merely observing that the assessee had not given any proof that while computing its return, it had correctly treated the said expenditure. We are afraid that on such basis the reopening would not be permissible. The petitioner has all throughout been contending that the expenditure was not claimed as revenue expenditure and the question of disallowing it as such would not arise. If the Assessing Officer had any doubt about such statement, he could have easily verified the correct facts from the return filed and other accompanying documents brought on record during the assessment proceedings. She simply could not have, in our opinion, brushed aside such a contention on the ground that such aspect was not examined by the Assessing Officer.

7. In addition to the above, we also perused the documents produced by the petitioner before us. Such documents include the return filed with the accompanying documents. One such document happens to be the schedule of administrative expenses at annexure II, which includes the said sum of Rs. 86.17 lakhs as a part of "capital work-in-progress". In face of such material on record, we

have no hesitation in coming to the conclusion that the first ground is factually incorrect. When the expenditure itself was never claimed by way of revenue expenditure, the question of disallowing such an expenditure on such basis requiring of reopening of assessment would not arise.

8. This brings us to second ground recorded by the Assessing Officer, which pertains to disallowance of proportionate expenditure for earning the tax free income. We may recall that in the opinion of the Assessing Officer, the petitioner who had earned tax free dividend income should have been subjected to disallowance of proportionate expenditure for earning such income on the basis of the formula provided in rule 8D of the income tax Rules, 1962. The petitioner opposes such reason mainly on two grounds. Firstly, that during the original assessment, this claim was examined at length and in the assessment order through a speaking order, part disallowance was made. Such issue cannot be a part of reopening proceedings. Secondly, that rule 8D would not be applicable with retrospective effect and, therefore, cannot be applied to assessment year 2007-08. On the other hand, the Revenue''s contention is that the Assessing Officer made part disallowance completely ignoring the provision of rule 8D and, therefore, the reopening of the assessment was necessary.

9. We may examine such contentions on the basis of material on record. Under a communication dated January 23, 2009, the petitioner with respect to such expenditure conveyed to the Assessing Officer its stand as under:

3. It is also inquired about as to why proportionate management expenses should not be disallowed u/s 14A in relation to earning of income which is exempt from tax, i.e., dividend based on the decision of Chennai Bench of the income tax Appellate Tribunal in the case of (2005) 93 TTJ 161

In this connection, it may please be noted that the company is engaged in the business of manufacturing and marketing of pharmaceutical and other related products. The investments in mutual funds/shares are made only to park surplus funds temporarily. The company is not in the business of trading in mutual fund or shares. The investments are made through the investment agents mainly into liquid/debt funds. The redemption/sale is directly credited to the bank account through ECS facility.

Thus, no managerial person is actively involved in the investment activities. The investment in the mutual fund particularly in liquid and debt funds does not require any active involvement or it is not a strategic decision. Therefore, the top management is not involved in such short-term investments since they are mainly made through the investment agents. Further, no other expenses are incurred in connection with the investment.

The decision of the Southern Petrochemicals Industries is not applicable on the facts of the assessee since the investment activities of Southern Petrochemicals

Industries were strategic decisions and in which top management was involved in such activities. In the present case, there are no strategic investments and therefore top management is not involved for investments in mutual funds/shares. The Chennai Bench in paragraph 6 of the order has restore the matter to the Assessing Officer with a direction to verify the quantum of deduction claim by the assessee in earlier years u/s 57 and make the prorate adjustment on the basis of fresh investments and inflation. Whereas in the case of the assessee-company, it may also be noted that in the earlier years, the company has not claimed any expenses against the dividend income u/s 57. The copy of statement of income for the assessment year 2003-04, during which dividend income was taxable, is enclosed to show that no expenditure was claimed u/s 57 from the dividend income. There was no dividend income during the assessment year 1997-98 or earlier years. Therefore, the decision of the Southern Petrochemicals is not applicable on the facts of the assessee company. Therefore, there is no question of disallowance of any expenditure.

10. Such issue cropped up once again when the assessee under its communication dated January 27, 2009 wrote to the Assessing Officer as under:

2. In the course of hearing, you have inquired about the application of section 14A in respect of investments made in shares and mutual fund having regard to the judgment of the Ahmedabad Bench of the income tax Appellate Tribunal in the case of (2004) 91 ITD 311

In this connection, it may please be noted that the above referred decision the assessee paid interest for the purpose of purchasing the shares and the same was disallowed u/s 14A by the Assessing Officer, which was confirmed by the income tax Appellate Tribunal. The hon''ble Tribunal held as under:

dividend income being exempt u/s 10(33), the interest on capital borrowed for acquisition of relevant shares cannot be allowed as deduction by operation of section 14A.

From the above, it may please be seen that after the insertion of section 14A, interest paid by the assessee for investments, the income from which is not taxable, the expenditure is not allowable as deduction. In the above referred case, the interest was paid for acquisition of shares and was not allowed by operation of section 14A.

In the present case, the company has invested in the shares of Addlife Medical Institute Ltd. and mutual fund out of the surplus from the current year plus redemption on mutual fund and deposit received back by the company. The company has furnished the relevant bank statement for showing the nexus of the investment to prove that the investments are made out of interest free funds. Thus, the company has not incurred any interest expenditure for the purpose of making investments.

Therefore, the abovereferred judgment of the income tax Appellate Tribunal is not applicable to the facts of the assessee''s case.

In view of the above and our earlier submission, there is no question of disallowance of any expenditure u/s 14A.

11. Once again under its communication dated March 16, 2009, the petitioner-assessee conveyed to the respondent as under:

1. In the course of hearing you have inquired about applicability of rule 8D with reference to the provisions of section 14A which has been inserted with effect from March 24, 2008, in respect of expenditure incurred for earning income which do not form part of total income.

In this connection it may please be noted that the rule 8D is applicable if the Assessing Officer ''having regard to the accounts of the assessee'' is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to income which does not form part of the total income as provided in section 14A(2).

In other words if having regard to the accounts of the assessee-company, the expenditure incurred to earn the income which does not form part of the total income is not available, then only the rule 8D can be applied.

In the present case the assessee-company has submitted the bank statements showing the nexus of the investment made from the owned funds by letter dated January 23 and 27, 2009. From the same it may please be seen that all investments in shares of Needwise Advertising Pvt. Ltd. and Mutual Funds are made out of owned funds and therefore there is no question of disallowance of any interest expenses. Further, there is a sufficient cash flow from the operations available with the company as can be seen from the cash flow statement.

Since the assessee-company has furnished the bank statement showing the nexus of the investment for the availability of the funds, the question of applicability of rule 8D also does not arise.

As regards indirect general expenses, it may please be noted that all investments are made in debt mutual funds which are normally risk free investments and therefore, there is no involvement of the top management in such investment activity. Accordingly, the following general expenses can be attributed for the purpose of such investment activities.

12. In the final order of assessment that the respondent passed, he dealt with this issue as under:

6. Disallowance u/s 14A

During the year under consideration, the assessee has shown dividend income of Rs. 1,45,30,317 from the investments shown by it at Rs. 74,23,49,881. Since the dividend earned are exempt from taxation, during the course of assessment proceedings, the assessee-company was asked to explain as to why the proportionate disallowance of expenses attributable to earning such tax-free income should not be made. In response to the show cause, the assessee-company, vide its submission dated March 16, 2009, has contended that all the investments made in the shares of Needwise Advertising Pvt. Ltd. and Mutual Funds are made out of owned funds and therefore, there is no question of disallowance of any interest expenses. The assessee, however, worked out the following general expenses, which are attributable to the above investments made.

Thus, an amount of Rs. 2,11,316 is disallowed from salary expenses and other expenses attributable to investment made in shares and securities, from which dividend is earned and claimed as exempt, and the same is added to the total income of the assessee-company.

13. From the above sequence of events, it clearly emerges that the question of disallowance of expenditure or part thereof u/s 14A of the Act for earning exempt income was very much alive before the Assessing Officer during the original assessment proceedings. In fact, such question was examined from various angles. The petitioner contended that no disallowance was called for. The petitioner through series of letters asserted its stand. In fact, in one such letter dated March 16, 2009, the petitioner pointedly addressed the issue of disallowance under rule 8D. In the present case, we are not judging the validity of the petitioner''s contention. What is important for our purpose is that the entire issue was scrutinised by the Assessing Officer during the original assessment proceedings. It is only upon consideration of the said aspect, he has made disallowance to the limited extent of Rs. 2,11,316. In our opinion, even within a period of four years such assessment cannot be reopened. Any permission to the Assessing Officer to do so would amount to permitting change of opinion. If the Department was of the opinion that the disallowance was not fitting the legal position, other remedy was available. Surely, to correct the assessment order passed after a detailed examination by the Assessing Officer, the succeeding Assessing Officer cannot resort to the proceedings of reopening. This is precisely what has been done in the present case. Under the circumstances, the impugned notice dated March 22, 2012, is quashed.

The petition is disposed of accordingly.